

Noncompete Clauses Used in Employment Contracts
Comment of the Global Antitrust Institute,
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February 7, 2020

This Comment is submitted to the Federal Trade Commission (FTC) in relation to its proposed examination of whether there is “a sufficient legal basis and empirical economic support” to promulgate a Commission rule that would restrict the use of noncompete clauses in employer-employee contracts.¹ We submit this Comment based upon our extensive experience and expertise in antitrust law and economics.² As an organization committed to promoting sound economic analysis as the foundation of antitrust enforcement and competition policy, the Global Antitrust Institute (GAI)

¹ See Press Release, Fed. Trade Comm’n, FTC to Hold Workshop on Non-Compete Clauses Used in Employment Contracts (Dec. 5, 2019), <https://www.ftc.gov/news-events/press-releases/2019/12/ftc-hold-workshop-non-compete-clauses-used-employment-contracts>.

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commends the FTC for inviting discussion in regard to regulation of this critical business practice.

Introduction

There has been an increased focus by academics, the U.S. competition authorities, and the Treasury Department on the effect of noncompete clauses on employee mobility, wages, and the efficiency of labor markets.³ These are important issues worthy of serious consideration by the competition authorities. We are concerned, however, that many proposals to address them through *ex ante* antitrust regulatory interventions, such as an FTC rule,⁴ are ill-suited and will likely do more harm than good.

³ See, e.g., Office of Econ. Policy, U.S. Dep't of the Treasury, NON-COMPETE CONTRACTS: ECONOMIC EFFECTS AND POLICY IMPLICATIONS (2016), (hereinafter "Treasury Report"), <https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf>; Evan Starr, J.J. Prescott & Norman D. Bishara, *Noncompetes in the U.S. Labor Force* (Univ. of Michigan Law & Econ Research Paper No. 18-013, 2019), <http://dx.doi.org/10.2139/ssrn.2625714>; Ioanna Marinescu & Herbert Hovenkamp, *Anticompetitive Mergers in Labor Markets*, PENN LAW: LEGAL SCHOLARSHIP REPOSITORY (Faculty Scholarship 2018), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=2967&context=faculty_scholarship (noting that vertical noncompete agreements between employers and employees can have horizontal effects if multiple employers in a labor market use them, and that such effects could be relevant to merger analysis as an exacerbating factor in assessing potential competitive harm); Alan B. Krueger & Eric A. Posner, *A Proposal for Protecting Low-Income Workers from Monopsony and Collusion* (The Hamilton Project, Feb. 2018), https://www.hamiltonproject.org/assets/files/protecting_low_income_workers_from_monopsony_collusion_krueger_posner_pp.pdf (recommending noncompetes to be uniformly unenforceable and banned if they govern an employee who earns less than the median wage in her state); Marshall Steinbaum, *A Missing Link: The Role of Antitrust Law in Rectifying Employer Power in Our High Profit, Low-Wage Economy* (Roosevelt Inst. Issue Brief, Apr. 2018), <https://rooseveltinstitute.org/wp-content/uploads/2018/04/Monopsony-issue-brief.pdf> (recommending banning noncompete agreements, no-poaching agreements, mandatory arbitration in employment contracts, and other similar competitive restraints in the labor market).

⁴ See, e.g., OPEN MARKETS INST. ET AL., PETITION FOR RULEMAKING TO PROHIBIT WORKER NON-COMPETE CLAUSES (Fed. Trade Comm'n, 2019), <https://openmarketsinstitute.org/wp-content/uploads/2019/03/Petition-for-Rulemaking-to-Prohibit-Worker-Non-Compete-Clauses.pdf> (hereinafter "OMI Petition"); Letter from Sen. Richard Blumenthal et al., to Joseph Simons, Chairman,

Specifically, some proposed *ex ante* interventions—including an outright ban on noncompete clauses—run the risk of condemning a long-standing employment practice that state laws already address. A ban might make economic sense were the evidence sufficient to show that noncompete clauses systematically reduce consumer or total welfare wherever used or when applied to an identifiable subset of employees, such as, lower wage employees. As discussed below, we do not believe the evidence currently supports such a blunt approach. Absent that evidence, a ban would risk falsely condemning procompetitive uses of noncompetes and thereby reducing productivity and dampening the incentives to invest in trade secrets and to disseminate firm-specific knowledge widely among a firm’s workforce.

In this comment, we survey the existing literature on the economic effects of employee noncompete clauses and discuss their current legal treatment—both at the state level and under federal antitrust law. We find that a blanket rule prohibiting the use of noncompetes—or even a more targeted ban—is not justified at this time. We also highlight the research finding that employees are often not fully informed regarding the terms of noncompete clauses and, when they are informed before employment, their

Fed. Trade Comm’n (Mar. 20, 2019), https://www.blumenthal.senate.gov/imo/media/doc/Sen%20Blumenthal%20et%20al%20re%20non%20competes_vF.pdf; Letter from the Attorneys General of Minnesota, California, Delaware, District of Columbia, Illinois, Iowa, Maine, Massachusetts, Maryland, Michigan, New Mexico, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, and Wisconsin, to Joseph Simons, Chairman, Fed. Trade Comm’n (Fed. Trade Comm’n, Nov. 15, 2019), http://www.illinoisattorneygeneral.gov/pressroom/2019_11/111519_Multistate_FTCNon-CompeteLetter.pdf

welfare improves. The idea is that, when employees are aware of noncompete clauses before employment, they are in a position to bargain for greater compensation. This result suggests a disclosure-based consumer protection type remedy might be more appropriate—and entail a lower risk of chilling procompetitive uses of noncompete clauses—than either a general or more limited ban.

Economics of Noncompete Clauses

Noncompete clauses are contractual provisions that prohibit an employee, after leaving a job, from working for a competing employer within a certain period of time and often within a specified geographic area. From the available data, noncompetes affect 18 to 20 percent of the U.S. workforce and nearly 40 percent have signed at least one noncompete agreement in the past.⁵ Not surprisingly, as with virtually all other forms of vertical restraints, economic research has identified both welfare-enhancing as well as welfare-reducing effects.⁶

Noncompete agreements may be justified for a number of reasons. Most important, noncompetes can encourage innovation by preventing employees who have

⁵ See Treasury Report, *supra* note 3; Starr et al., *supra* note 3 at 6.; see also John M. McAdams, *Non-Compete Agreements: A Review of the Literature* at 3 (December 31, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3513639 (“Data on non-compete use in the U.S. are sparse...Researchers have conducted four surveys of non-compete use in the U.S., one of which is national in scope and covers a broad range of occupations, and three of which cover specific occupations. These surveys are the basis of many studies within the literature.”).

⁶ Noncompetes are considered “vertical” rather than “horizontal” restraints since they are intended to specify terms to an “upstream” input, *i.e.*, employees.

acquired trade secrets and other firm know-how from transferring that intellectual property to a rival.⁷ While it has been argued that trade secrecy laws perform that function,⁸ noncompetes may represent a more efficient mechanism to prevent proprietary knowledge transfers in certain circumstances, particularly when monitoring and the enforcement of trade secrets law is costly.⁹ With a greater assurance that valuable, firm-specific information will not be transferred to a rival (at least for a period of time), noncompete agreements can encourage greater employer investments in employee training and human capital.¹⁰ In essence, the ability to use noncompete clauses can solve the “hold up” problem where a firm is reluctant to invest *ex ante* in employees unless the firm is protected *ex post*, that is, after the employees have acquired their knowledge. Again, while trade secrecy laws or nondisclosure clauses could, in theory, be used instead of noncompetes, they would not be as effective or efficient as noncompetes in certain circumstances.

⁷ See Treasury Report, *supra* note 3, at 9–10 (“[N]on-competes can encourage additional economic activity and broader information sharing when trade secrets are significant. The training and screening explanations for noncompete agreements also suggest social benefits. If employee training is sufficiently enhanced by the availability of noncompetes, or if firms with unusually high separation costs are able to match more appropriately with employees, both employee and firm are better off.”).

⁸ See, e.g., Alan Hyde, *Should Noncompetes Be Enforced?*, REGULATION, Winter 2010-11, at 6-11; OMI Petition, *supra* note 4.

⁹ Arguably, the practice of *not* using noncompetes could be construed as not engaging in a sufficient effort to maintain secrecy and hence the protection of trade secrecy laws; perhaps this concern might be mitigated through the use of nondisclosure clauses.

¹⁰ See, e.g., Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not to Compete*, 10 J. LEGAL STUD. 93, 93 (1981) (“restrictive covenants were and are necessary in some circumstances to lead to efficient amounts of investment in human capital”).

The above discussion is reminiscent of the vertical integration versus vertical control decision. While vertical contracts can be useful in mitigating hold up or other potential inefficiencies along a vertical supply chain, in some circumstances, vertical integration is the more efficient solution.¹¹ Even within vertical contracts, some mechanisms to ensure performance may be more effective than others, depending upon the context. For instance, one justification for exclusive dealing arrangements is to induce sufficient levels of retailer investments in various forms of promotion (display, product range and inventory maintenance, sales effort, *et cetera*). Even if there are alternative mechanisms available, they may not be as feasible or cost effective in certain situations. Thus, merely identifying alternative mechanisms to solve a potential employee investment-problem does not provide policymakers useful guidance as to which mechanism achieves the objective at the lowest social cost. Indeed, it may not be possible to determine *ex ante* the circumstances, in a generalizable way, under which noncompetes are the more efficient mechanism. In these circumstances, it is better to leave their use to the discretion of individual market participants—assuming there is full information on both sides of the bargain. Of course, if one side has excessive market

¹¹ See, e.g., Benjamin Klein, Robert G. Crawford, & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. OF LAW & ECON. 297, 298 (1978) (“The crucial assumption underlying the analysis of this paper is that, as assets become more specific and more appropriable quasi rents are created (and therefore the opportunistic behavior increases), the costs of contracting will generally increase more than the costs of vertical integration.”); Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REVIEW 112, 113 (1971) (“In circumstances, therefore, where protracted bargaining between independent parties to a transaction can reasonably be anticipated, internalization becomes attractive.”).

power in the labor market, then that is a relevant consideration in determining the role that the noncompetes should play in that market.

Another potential benefit to noncompetes is that they can effectively sort employees into specific “types,” *i.e.*, those who have a low versus a high probability of leaving a firm within a given time.¹² Only those with low probabilities of leaving will be willing to agree to a noncompete clause. In these circumstances, noncompetes can serve as a fairly low-cost approach to solve an information problem.

These potential benefits to the use of noncompetes are achieved, however, by limiting an employee’s ability to switch jobs and to negotiate for better conditions and higher wages (assuming the best alternative employment opportunity is affected by the clause). It can even lead to prolonged unemployment if an employee is unable to find a new job that is not precluded by the noncompete. In addition, these restrictions on employees can increase the cost of entry or expansion by rivals in the downstream product market. Ultimately, these restrictions on labor touch upon a fundamental concern that employee freedom and mobility will be negatively affected without a sufficient offsetting benefit.

While these concerns are understandable, the relationship between mobility and efficiency in labor markets is not necessarily straightforward. It is often claimed that labor mobility is good for economic efficiency, but it is the *option*—not necessarily the

¹² See Treasury Report, *supra* note 3, at 8-9.

choice—to move that improves efficiency. Specifically, employee welfare is a function of various things—the most important typically being wages but also training and other developments of human capital; hence, the willingness of college and graduate students to intern for low or even no wages. Employees may be willing to trade off greater mobility for higher wages and/or greater opportunities to develop their human capital. For instance, a job that incentivizes a two-year commitment (*e.g.*, with a bonus payment at the end of the term) involves asking the employee to give up some mobility (or, more accurately, raises the cost of being mobile) in exchange for something the employee values more. Consequently, observations regarding changes in an employee's mobility do not, in of themselves, inform us about a particular employee's welfare or about the welfare of employees in the aggregate.

To be certain, a reduction in labor mobility can decrease economic efficiency. But when are employee freedom and mobility, and reductions in either or both, an antitrust problem? Are lower or higher wages an antitrust issue? It is important to emphasize that employee welfare is not the same as consumer or total welfare. In other words, a change in an input market does not necessarily translate into a harm in the output market. For instance, noncompetes may be associated with reduced costs to the firm and with lower prices and greater quantity in the output market. Indeed, Gurun et al. (2019) find that noncompetes reduced employee mobility but lowered costs and prices

to consumers.¹³ This study represents the first large-scale effort to examine the effect of noncompetes based upon firm-level variation. They find that when firms in the financial advisory industry agree not to enforce noncompetes (through participation in an industry “protocol” that prohibits firms from taking legal action against employees), the following effects ensue: (1) net employee turnover does not increase but the cost of turnover increases because advisors can now take clients with them; (2) firms are more reluctant to discipline advisor misconduct for fear of advisors taking clients with them—which leads to more incidents of misconduct (more than a 40 percent increase); and (3) firms increased client fees by 14 percent. These results confirm the unavoidable fact that a change in welfare in an input market does not directly map onto a similar change in consumer welfare in the output market.¹⁴ Those tradeoffs break the link between harm to employees and a reduction in total or consumer welfare.

Putting aside the larger question of how noncompetes affect either total or consumer welfare, the available empirical evidence is mixed even in terms of assessing how noncompete agreements affect employees. Among those who find welfare

¹³ Umit G. Gurun et al., *Unlocking Clients: Non-Compete Agreements in the Financial Advisory Industry*, (Kelley School of Bus. Research Paper No. 18-29, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3132127.

¹⁴ This has implications for any FTC rulemaking efforts in the area of noncompetes given that the bipartisan UMC Policy Statement tethers the definition of an “unfair method of competition” to “consumer welfare” and a rule of reason analysis. Therefore, evidence that a practice reduced wages, without more, would fall short of satisfying the Commission’s own definition of an unfair method of competition. *See* Fed. Trade Comm’n, Statement of Enforcement Principles Regarding “Unfair Methods of Competition” Under Section 5 of the FTC Act (Aug. 13, 2015), (hereinafter UMC Statement), https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf.

enhancing effects for employees, Lavetti et al. (2019) find that physicians who sign noncompetes tend to earn more because they are allocated more clients.¹⁵ This leads them to conclude: “Whereas one concern about the use of NCAs [noncompete agreements] is that they could harm employees, these patterns suggest that bundling NCAs with incentive-based compensation contracts can overcome the impacts of reducing workers’ bargaining power.”¹⁶ Garmaise (2011) finds that noncompetes reduce holdup, which increases the incentive for firm-sponsored training, but tends to decrease employees’ incentives to invest in other general skills.¹⁷ Conti (2014) combines a state-level measure of enforceability with data on employee and firm outcomes in order to compare high versus low enforceability regimes and finds the enforceability of noncompetes allows firms to engage in riskier R&D investments since concerns regarding leaks are mitigated.¹⁸ Younge and Marx (2016) find that the ratio between a firm’s market value and the value of its assets, *i.e.*, its Tobin’s *q*, increased by 9.75 percent after noncompetes became enforceable in Michigan.¹⁹

¹⁵ Kurt Lavetti et al., *The Impacts of Restricting Mobility of Skilled Service Workers: Evidence from Physicians*, J. OF HUMAN RES. at 3 (Feb. 7, 2019), http://kurtlavetti.com/UIPNC_vf.pdf (“Using three years of longitudinal earnings data per physician, we estimate that NCAs increase the annual rate of earnings growth by an average of 8 percentage points in each of the first 4 years of a job, with a cumulative effect of 35 percentage points after 10 years on the job.”).

¹⁶ *Id.* at 42.

¹⁷ Mark J. Garmaise, *Ties that Truly Bind: Non-competition Agreements, Executive Compensation and Firm Investment*, 27 J. OF LAW, ECON., AND ORG. 2, at 376-425 (August 2011).

¹⁸ Raffaele Conti, *Do Non-Competition Agreements Lead Firms to Pursue Risky R&D Projects?*, STRATEGIC MGMT. J., at 1230-48 (July 7, 2014).

¹⁹ Kenneth A. Younge & Matt Marx, *The Value of Employee Retention: Evidence from a Natural Experiment*, 25 J. OF ECON. & MGMT. STRATEGY 652 (2016).

On the other hand, there are a number of studies that find that noncompetes have a negative effect on employee wages. Balasubramanian et al. (2018) find that, after a ban on noncompetes for technology employees in Hawaii, mobility increased by 11 percent and new-hire wages increased 4 percent.²⁰ Similarly, Johnson et al. (2019), using a state-level panel data, find that moving from the 10th to 90th percentile in state enforcement of noncompetes is associated with at three to four percent decrease in wages and a nine percent decline in the probability of changing jobs.²¹ Lipsitz and Starr (2019) examine the effect of Oregon’s 2008 ban on noncompetes for low-wage workers and find that hourly wages increased 2.2 to 3.1 percent, on average, although, they find no effect for those with less than a high school degree.²² Starr et al. (2018) find that, in industries with greater noncompete use and enforceability, wages and mobility are lower and there are fewer job offers.²³ Fallick et al. (2006) find evidence that employees in California’s computer industry, but not in other industries, are more mobile compared to employees in other states—which suggests the effect of California’s non

²⁰ Natarajan Balasubramanian, Jin Woo Chang, Mariko Sakakibara, Jagadeesh Sivadasan & Evan P. Starr, *Locked In? The Enforceability of Covenants Not to Compete and the Careers of High-Tech Workers* (U.S. Census Bureau Center For Econ. Studies Paper No. CES-WP-17-09, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2905782.

²¹ Matthew S. Johnson et al., 2019, *The Labor Market Effects of Legal Restrictions on Worker Mobility* (Sept. 22, 2019).

²² Michael Lipsitz & Evan Starr, *Low-Wage Workers and the Enforceability of Non-Compete Agreements* (Dec. 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452240.

²³ Evan Starr, Justin Frake & Rajshree Agarwal, *Mobility Constraint Externalities*, ORG. SCI. (forthcoming 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3027715.

enforcement of noncompetes may be limited to the tech sector.²⁴ Again, however, it is the option to be mobile—not actual labor mobility—that improves efficiency.

Importantly, Starr et al. (2019) find the effect of noncompetes on employee outcomes depends upon timing.²⁵ Specifically, when employees are aware of noncompetes before accepting an offer, wages are 9.7 percent higher, relative to employees without noncompetes, and the likelihood of receiving training is higher. In contrast, employees who agree to noncompetes after employment see no change in wages or training levels, relative to employees without noncompetes.²⁶ One potential implication is that, when employees are aware of noncompetes they may demand compensation to offset their loss of mobility to rivals within the scope of the noncompete. Thus, the conditions under which noncompetes are presented matters for employee outcomes.

In sum, the empirical evidence on the effect of noncompetes on employee welfare is still largely not settled—at least not to the degree that would allow one to draw broad policy conclusions. The evidence certainly suggests the potential for both harms and benefits to employees. It also suggests mixed results for the effect on total

²⁴ Bruce Fallick et al., *Job-Hopping in Silicon Valley: Some Evidence Concerning the Microfoundations of a High-Technology Cluster* (NBER Working Paper 11710, 2005), <https://www.nber.org/papers/w11710.pdf>.

²⁵ See Starr et al., *supra* note 3, at 35 (“these results imply that policies that encourage the disclosure of all job-relevant information to employees before job acceptance may help employees receive appropriate compensation for giving up their right to compete.”). See also Evan Starr, *Consider This: Training, Wages, and the Enforceability of Covenants Not to Compete*, 72 ILR REVIEW 783 (2019).

²⁶ *Id.* at 3.

welfare. During the recent FTC hearings on noncompetes, Lavetti (2020) similarly concluded we are “[s]till far from reaching a scientific standard for concluding NCAs are bad for overall welfare... Also [we] don’t yet fully understand the distribution of effects on workers...Welfare tradeoffs are likely context-specific, and may be heterogeneous.”²⁷

We agree with the FTC’s own staff economist, McAdams (2019) who describes the empirical literature as follows:

Although the literature has made important strides in studying non-competes and their effects on workers, firms, and end consumers, further work is needed. Due to the limited availability of data and a paucity of natural experiments (e.g., law changes) to assess the impact of non-competes, much of the literature relies on cross-sectional comparisons of signers and non-signers, or high-enforceability states and low-enforceability ones. The more credible empirical studies tend to be narrow in scope, focusing on a limited number of specific occupations (e.g., executives) or potentially idiosyncratic policy changes with uncertain and hard-to-quantify generalizability (e.g., banning non-competes for technology workers in Hawaii). There is little evidence on the likely effects of broad prohibitions of non-compete agreements. Further research, perhaps exploiting more recent law changes or new sources of data, is necessary to establish the causal impact such agreements have on market participants.²⁸

In sum, we conclude the overall state of the evidence is not adequate to support even a narrowly tailored rule aimed at prohibiting noncompetes for employees with low wages, let alone a broad ban on noncompetes. In time, however, as more empirical

²⁷ Kurt Lavetti, Economic Welfare Aspects of Non-Compete Agreements, Remarks at the Fed. Trade Comm’n Workshop on Non-Compete Clauses in the Workplace (Jan. 9, 2020), https://www.ftc.gov/system/files/documents/public_events/1556256/non-compete-workshop-slides.pdf.

²⁸ See McAdams, *supra* note 5, at 4.

evidence develops, there will be an opportunity to reevaluate this conclusion. Indeed, even over the past few years, there has been a significant number of new working papers looking at state-specific and industry-specific effects, which clearly demonstrate an opportunity to learn and rely on the laboratory of the states. Given the likelihood of further changes in state laws, these opportunities will surely grow over time.

Legal Treatment of Noncompetes

The legality of noncompetes is primarily governed by state law. According to Hausman and Lavetti (2019), “The permissibility of NCAs dates back to at least 1621 under English common law, and 39 US states still follow common law in determining the enforceability of NCAs.”²⁹ Most states enforce noncompetes with a “reasonableness test,” which balances protection of the employer’s information and know-how against the injury to the employee.³⁰ In practice, the enforceability of these standards also depends upon whether employees are allowed to litigate and have not agreed to arbitration.

States vary in their enforceability regimes for noncompetes, depending upon a number of different factors: Whether noncompetes are enforceable for voluntary and non-voluntary work separations; whether consideration is required beyond the job

²⁹ Naomi Hausman & Kurt Lavetti, Physician Practice Organization and Negotiated Prices: Evidence from State Law Changes (Aug. 31, 2019) (unpublished manuscript), http://kurtlavetti.com/NCA_price_vc.pdf.

³⁰ See Treasury Report, *supra* note 3.

itself; whether the employer has a protectable or legitimate interest to justify a noncompete; and the treatment of these clauses by state courts.³¹ Noncompetes are permitted in most states with the exception of California,³² North Dakota,³³ and, Oklahoma.³⁴ Additionally, in 2019, the Vermont Legislature considered a bill that would prohibit all noncompete agreements.³⁵ Among states that allow noncompetes, thirty-two have adopted the equitable reform doctrine.³⁶ Nine states have adopted the blue pencil doctrine.³⁷ And three states have adopted the more restrictive red pencil doctrine.³⁸ Finally, there is a degree of uncertainty about the treatment of noncompetes in a few states and the District of Columbia.³⁹

³¹ Broadly speaking, the different states have adopted three main regulatory systems or “doctrines” for dealing with employee noncompetes: (i) red-pencil doctrine, requiring that the court declare an entire noncompete contract void if one or more of its provisions are found to be defective under state law or precedent; (ii) blue-pencil doctrine, requiring that courts delete provisions of a noncompete contract that render it overbroad or otherwise defective, while retaining the enforceable subset of the contract; and (iii) equitable reform doctrine, providing that courts may rewrite a noncompete contract removing defective provisions. *See* Treasury Report, *supra* note 3; *see also* Beck Reed Riden LLP, *Employee Noncompetes, A State by State Survey* (Apr. 27, 2019), <https://www.beckreedriden.com/wp-content/uploads/2019/04/Noncompetes-50-State-Survey-Chart-20190427.pdf>.

³² *See* CAL. BUSINESS & PROFESSIONS CODE § 16600 (1941).

³³ *See* N.D. CENT. CODE § 9-08-06 (effective Aug. 1, 2019).

³⁴ *See* OK STAT. § 15-219A (2014).

³⁵ *See* Vermont Bill H.1, H.R. 1, 2019 Leg. (Vt. 2019), <https://legislature.vermont.gov/bill/status/2020/H.1>.

³⁶ These states are Alabama, Alaska, Arkansas, Colorado, Delaware, Florida, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Washington, West Virginia, Wyoming. *See* Beck Reed Riden, *supra* note 31.

³⁷ These states are Arizona, Connecticut, Georgia, Indiana, Louisiana (if allowed by the noncompete), Maryland, Montana (blue pencil likely), North Carolina, and South Carolina (blue pencil likely). *See* Beck Reed Riden, *supra* note 31.

³⁸ These states are Nebraska, Virginia (although, portions can be enforced if the remaining restrictions are otherwise enforceable), and Wisconsin. *See* Beck Reed Riden, *supra* note 31.

³⁹ The District of Columbia had adopted reformation or blue pencil, in Vermont the treatment depends on the contract, and in New Mexico and Utah the issue is undecided. *See* Beck Reed Riden, *supra* note 31.

All states that have regimes to enforce employee noncompetes condition them upon the protection of legitimate business interests, such as trade secrets. Several states also include the protection of commercially sensitive information, such as contracts, client, or vendor lists. Finally, some states also specifically mention specialized and unique training as an interest that is protectable via a noncompete agreement.⁴⁰

Given the potential for employees to find themselves unknowingly bound by a noncompete, some states have passed “consideration” laws,⁴¹ which tie the enforceability of noncompetes to some sort of consideration, such as the employer providing higher wages, promotions, or training. Additionally, many states have adopted standards requiring that noncompetes be narrowly tailored in terms of time and geographic reach, and/or be applied only to “key” or professional staff.⁴² Several states have passed legislation prohibiting noncompetes for certain low wage employees or for employees within specific industries.⁴³ In 2008, for example, Oregon banned the use of noncompetes for hourly employees.⁴⁴ Further, the Illinois Freedom to Work Act,

⁴⁰ For instance, in Alabama, protectable or legitimate interests include: “unique training involving substantial business expenditure specifically directed to a particular agent, servant, or employee (if identified in writing as consideration for the restriction);” in DC “expert training;” in Florida “extraordinary or specialized training,” etc. See Beck Reed Riden *supra* note 31, at 1, 3.

⁴¹ Examples include Alabama, Massachusetts, Montana, Nevada, Texas. See Beck Reed Riden *supra* note 31, at 1, 7, 9-10, 16.

⁴² See Beck Reed Riden *supra* note 31, at 3.

⁴³ See e.g., MD. CODE LAB. & EMPL. § 3-716 328 (2019) (voiding noncompetes for employees earning less than \$31,200 annually); WASH. REV. CODE § 49.62.020 (2019) (voiding noncompetes signed by employees making less than \$100,000 annually and independent contractors earning less than \$250,000 annually); COLO. REV. STAT. § 8-2-113 (2018) (physicians and executives are exempted).

⁴⁴ See OR. REV. STAT. § 653.295(1)(b); OR. REV. STAT. § 653.020(3). For an assessment of the impact of the Oregon law change on wages, see Michael Lipsitz & Evan Starr, *supra* note 22.

prohibits the use of non-compete agreements for employees who earn \$13 an hour or less.⁴⁵ Similarly, Hawaii enacted legislation prohibiting the enforcement of noncompetes for technology employees,⁴⁶ and several states prohibit the enforcement of noncompetes for specific types of healthcare employees.⁴⁷

This survey indicates that, with few exceptions, the enforcement of noncompete clauses depends upon the specific circumstance and context. There is broad recognition that noncompetes can have both welfare-enhancing and welfare-reducing effects, which is precisely the main finding of the economics literature. Courts generally balance considerations of legitimate business interests with the effect on employees and even the public good. In general, these agreements are treated more favorably when they are applied to skilled employees in order to ensure the protection of legitimate business interests, are disclosed *ex ante*, and are entered into for consideration.

What, then, is the proper course for the FTC with regard to restricting the use of noncompetes—even for a subset of the labor force, such as low wage employees. As the preceding overview clearly indicates, states have chosen to deal with noncompetes in

⁴⁵ Illinois Freedom to Work Act, 820 ILL. COMP. STAT. 90/1. Similarly, in February 2019, the New Hampshire Senate approved a bill that would prohibit employers from requiring low-wage employees to enter into non-compete agreements, making such agreements void and unenforceable. *See* N.H. S.B. 197, Reg. Sess. (N.H. 2019). In Washington State, legislation banning noncompete agreements for employees that earn less than \$100,000 per year. *See* H.R. 1450, 66th Leg., Reg. Sess. (Wash. 2019). In Maryland, legislation was enacted voiding noncompetes for employees earning less than \$15 per hour or \$ 31,200 annually. *See* Md. H.B. 38, Reg. Sess. (Md. 2019). Finally, the New York Attorney General has proposed legislation that would prohibit non-competes for employees earning below \$75,000 per year, *inter alia*. *See* N.Y. Assembly B. A07864 (N.Y. 2017).

⁴⁶ *See* HAW. REV. STAT. § 480-4 (2011).

⁴⁷ *See* N.H. REV. STAT. § 329:31-a (2016).

very different ways. State laws and court decisions have developed over a substantial period of time and are continuing to develop. Before adopting any rule that would override those laws, the FTC should have a sound basis for believing it will be improving outcomes for the economy in general and for affected employees in particular.

Noncompete Clauses and Antitrust Law

Antitrust enforcement has proven to be a good tool for addressing problems in labor markets that involve collusive or coordinated practices, such as horizontal wage fixing or non-poaching agreements.⁴⁸ Thus far, however, we are aware of no individual case involving employee noncompetes having market effects that would call for antitrust intervention.

Because noncompetes are vertical restraints, they are analyzed under the rule of reason.⁴⁹ The competitive analysis typically involves a review of the reasonableness of the duration, and geographic coverage of the noncompete, and whether the restraint is reasonably related to a legitimate business purpose. Courts have considered as legitimate purposes, *inter alia*, protecting a purchaser's ability to realize the full value of

⁴⁸ See *California v. eBay, Inc.*, 2014 WL 4273888 (N.D. Cal. Aug. 29, 2014); see also Dep't of Justice, Antitrust Div. & Fed. Trade Comm'n, *Antitrust Guidance for Human Resource Professionals* 4 (Oct. 2016), <https://www.justice.gov/atr/file/903511/download>; OECD, *Competition Concerns in Labour Markets – Background Note By the Secretariat*, at ¶ 10 (June 5, 2019), [https://one.oecd.org/document/DAF/COMP\(2019\)2/en/pdf](https://one.oecd.org/document/DAF/COMP(2019)2/en/pdf).

⁴⁹ See *Cont'l T.V. v. GTE Sylvania*, 433 U.S. 36, 59 (1977).

a purchased business and protecting an employer's valuable personal contacts or trade secrets.⁵⁰ Most of the cases deal with breaches contract rather than antitrust injury.

In the European Union, employee noncompetes have not been subject to antitrust investigations or sanctions by the Directorate General for Competition. However, if an employee noncompete were of a magnitude to merit EU scrutiny,⁵¹ and assuming that employees could be considered "undertakings,"⁵² the analysis would be similar to that in the U.S., *i.e.*, the conduct would be analyzed according to its effects in the market. The agreements would be analyzed under Article 101 of the Treaty on the Functioning of the European Union (TFEU) or, if the employer is considered dominant, under Article 102 of the TFEU.

⁵⁰ For example, in *Golden Rd. Motor Inn, Inc. v. Islam*, the Supreme Court of Nevada acknowledged the free-rider justification for employee non-compete agreements but struck down the non-compete because the covenant was overly broad, as it extended beyond what was necessary to protect the employer's legitimate interests. 376 P.3d 151, 155 (Nev. 2016). Similarly, in *Delaware Elevator, Inc. v. Williams*, the court rewrote a non-compete covenant in line with Maryland's law, limiting its scope from a 100-mile radius to 30 miles, and from three years to two years. 2011 WL 1005181, *9-12 (Del. Ch. March 16, 2011).

⁵¹ See Eur. Comm'n, *Notice on Agreements of Minor Importance Which Do Not Appreciably Restrict Competition Under Article 101(1) of the Treaty on the Functioning of the European Union (De Minimis Notice)*, Official Journal of the European Union 57 (Aug. 30, 2014), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2014:291:FULL&from=EN>.

⁵² See Case C-41/90, *Höfner and Elser v. Macrotron GmbH* [1991] ECR I-1979; see also Ioannis Lianos, Nicola Countouris & Valerio de Stefano, *Rethinking the Competition Law/Labour Law Interaction Promoting a Fairer Labour Market* (Centre for Law, Econ. and Society, UCL Research Paper Series, 2019), https://www.ucl.ac.uk/cles/sites/cles/files/cles_3-2019.pdf (explaining that the concept of "undertaking is widely interpreted as 'an entity engaged in economic activity.' It includes individual persons offering goods or services on a market where they bear financial risk attached to the performance of those services. However, an employee cannot be an undertaking as it does not exercise an autonomous economic activity, in the sense of offering goods or services on a market and bearing the financial risk attached to the performance of such activity." (quoting *Höfner and Elser*)).

There is likewise a complete absence of antitrust cases involving noncompetes among the Member States of the EU. For example, the Spanish Competition Authority recently reported to the OECD that: “no cases have been submitted which involve a concentration of employment demand power (or of purchasing employment) or in a certain entity in relation to a reference market made up of providers of work (workers).”⁵³ Similarly, the Portuguese authority reported to the OECD that it has not adopted any decision condemning undertakings in their role as employers for prohibited practices (agreements, concerted practices, and decisions by associations of undertakings) involving no-poach or wage-fixing agreements.⁵⁴ Nor is there any decisional precedent with regard to the potential applicability of Article 9 of the Portuguese Competition Act and Article 101 TFEU in Portugal. Croatia, on the other hand, reported two cases related to labor markets, both dealing with employee no-poach agreements, one vertical (where the company was found dominant) and the other horizontal, that ended with commitments by the investigated parties.⁵⁵

In brief, the impact of employee noncompetes on competitive outcomes is uncertain and likely depends upon each particular industry and circumstance. There is a fundamental difference between employee welfare and consumer welfare. Given that

⁵³ OECD, *Competition Issues in Labour Markets –Note by Spain* (June 5, 2019), [https://one.oecd.org/document/DAF/COMP/WD\(2019\)48/en/pdf](https://one.oecd.org/document/DAF/COMP/WD(2019)48/en/pdf).

⁵⁴ OECD, *Competition Issues in Labour Markets- Note by Portugal* (June 5, 2019), [https://one.oecd.org/document/DAF/COMP/WD\(2019\)47/en/pdf](https://one.oecd.org/document/DAF/COMP/WD(2019)47/en/pdf).

⁵⁵ OECD, *Competition Issues in Labour Markets- Note by Croatia* (June 5, 2019), [https://one.oecd.org/document/DAF/COMP/WD\(2019\)41/en/pdf](https://one.oecd.org/document/DAF/COMP/WD(2019)41/en/pdf).

the lodestar of antitrust remains the consumer welfare standard,⁵⁶ noncompetes should be considered of antitrust concern only when they raise consumer welfare issues.

Rulemaking Petitions

The Open Markets Institute, 19 labor and public interest organizations, and 46 individual advocates and scholars (OMI) petitioned the FTC pursuant to the Administrative Procedure Act, 5 U.S.C. §553 , and the Federal Trade Commission Act, 15 U.S.C. § 45, to issue a regulation prohibiting noncompetes (OMI Petition).⁵⁷ The OMI Petition proposes that “[t]hrough a rulemaking, the FTC should declare worker non-compete clauses to be an unfair method competition and classify them as per se illegal under the FTC Act.”⁵⁸ This petition was further supported by a letter from of seven

⁵⁶ Tad Lipsky, Joshua D. Wright, Douglas H. Ginsburg & John M. Yun, *The Federal Trade Commission’s Hearings on Competition and Consumer Protection in the 21st Century, the Consumer Welfare Standard in Antitrust Law*, Comment of the Global Antitrust Institute, Antonin Scalia Law School, George Mason University (George Mason Law & Economics Research Paper No. 18-26, Sept. 7, 2018), <http://dx.doi.org/10.2139/ssrn.3245912>.

⁵⁷ See OMI Petition, *supra* note 4; see also Letter from Sen. Richard Blumenthal et al., *supra* note 4.

⁵⁸ See OMI Petition, *supra* note 4, at 49. This type of rulemaking initiative has received some support from FTC Commissioner Rohit Chopra:

“Given the prevalence of forced arbitration provisions in many contractual agreements, private enforcement is almost non-existent with respect to these clauses and other restraints that may harm competition. That’s why government action is so essential. The FTC has the authority to define “unfair methods of competition” by rule and is uniquely positioned to take action. Earlier this year, the Commission received a petition for such a rulemaking on non-compete clauses, a petition worthy of public consideration.”

See Fed. Trade Comm’n, Opening Remarks of FTC Commissioner Rohit Chopra Future of Work Roundtable U.S. House of Representatives Committee on Education & Labor (Oct. 16, 2019), https://www.ftc.gov/system/files/documents/public_statements/1552143/chopra_-_opening_remarks_before_committee_on_education_labor_future_of_work_roundtable_10-16-19.pdf;

Democratic senators (“Senators’ Petition”) urging the FTC to use its rulemaking authority, “along with other tools” to protect employees against the proliferation of noncompete clauses.⁵⁹ The Senators’ Petition reflects a widespread concern regarding the perceived harmful effects of noncompetes for employees; refers to the OMI Petition; and echoes similar arguments, including that employees lack the bargaining power to resist these clauses. Eighteen state Attorneys General issued a narrower recommendation that the FTC prohibit noncompetes for low-wage employees through rulemaking under Section 5 of the FTC Act.⁶⁰ Finally, senators of both parties have

See also Fed. Trade Comm’n, Comment Submission of Commissioner Chopra to Department of Justice Initiative on Labor Market Competition (Sept. 18, 2019), https://www.ftc.gov/system/files/documents/public_statements/1544564/chopra_-_letter_to_doj_on_labor_market_competition.pdf.

“A rulemaking proceeding that defines when a non-compete clause is unlawful is far superior than case-by-case adjudication. The proceeding would allow a broad array of stakeholders, not just a plaintiff and a defendant, to contribute to the development of the law. Earlier this year, the Commission received a petition for rulemaking on non-compete clauses. I strongly support opening up a docket for public comment on this petition to aid the Commission in crafting any potential rulemaking proposals.”

⁵⁹ *See* Letter from Sen. Richard Blumenthal et al., *supra* note 4.

⁶⁰ The 18 State Attorneys General recommend:

“The FTC should consider using its Section 5 enforcement authority to stop the use of non-compete, non-solicitation, and no-poach agreements in many situations. At a minimum, we recommend that the FTC use its authority to ban intra-franchise no-poach agreements and non-compete agreements for low-wage workers. We understand that the FTC is studying such action right now. We further propose the FTC consider a ban on non-competes involving multi-sided platforms.”

See Fed. Trade Comm’n Hearings on Competition and Consumer Protection in the 21st Century, Public Comments of 18 State Attorneys General on Labor Issues in Antitrust at 13 (July 15, 2019), https://oag.dc.gov/sites/default/files/2019-07/State_AGs_Comments_to_FTC_on_Labor_Issues_in_Antitrust.pdf

submitted federal legislative proposals that would either completely ban noncompetes or ban their application to low-wage employees.⁶¹

The OMI Petition proposes a dramatic shift of antitrust enforcement under Section 5 of the FTC Act.⁶² In our view, the proposal is not consistent with the body of empirical evidence concerning the ambiguous effect of noncompetes not only on employees, but on competition and consumer welfare generally. The evidence, as discussed above, supports a rule of reason approach already embodied in the bipartisan FTC Unfair Methods of Competition Policy Statement.⁶³ The UMC Policy Statement also commits the FTC to use its Section 5 UMC authority to target practices that harm competition and consumer welfare, and not to pursue broader public policy goals.⁶⁴ Departing from the consumer welfare standard in a rule restricting or prohibiting

⁶¹ Connecticut Senator Chris Murphy proposed the “Workforce Mobility Act of 2018” that would prohibit noncompete agreements for most employees. *See* Workforce Mobility Act of 2018, S. 2782, 115th Cong., (2018). Florida Senator Marco Rubio proposed the “Freedom to Compete Act,” that would ban the use of noncompete agreements for certain low-wage employees. *See* Freedom to Compete Act, S. 124, 116th Cong., (2019).

⁶² The OMI Petition further advocates *per se* treatment of noncompetes under Section 1 of the Sherman Act. or at least treating these agreements as “inherently suspect” under Section 1 of the Sherman Act by applying the “truncated” rule or reason analysis in *PolyGram*. *See* OMI Petition, *supra* note 4, at 4, 49-53 (“Considering the documented harms and unconvincing business justifications for non-competes, the FTC should hold worker non-compete clauses to be an unfair method of competition and categorize them as *per se* illegal;” “Relying on Polygram, non-competes conduct should be considered presumptively illegal under the Sherman Act because they are ‘inherently suspect owing to its tendency to suppress competition’.”). These propositions must be rejected because “inherently suspect” practices must be reliably known to harm competition. *See Polygram Holding, Inc. v. F.T.C.*, 416 F.3d 29, 36–37 (D.C. Cir. 2005) (holding that “the rebuttable presumption of illegality arises not necessarily from anything ‘inherent’ in a business practice but from the close family resemblance between the suspect practice and another practice that already stands convicted in the court of consumer welfare.”).

⁶³ *See* UMC Statement, *supra* note 14.

⁶⁴ *Id.*

noncompetes would depart from the UMC Policy Statement without a strong evidentiary basis for doing so, increasing uncertainty and strengthening charges that competition agencies are prone to political influence.⁶⁵

Noncompetes, Disclosure, and the Role of Consumer Protection

Antitrust and consumer policy are complementary and reinforce each other in their overarching goal of enhancing consumer welfare.⁶⁶ The two policies, however, address consumer welfare from different perspectives.⁶⁷ Antitrust approaches the market from the supply-side, seeking to ensure that markets are efficient and competitive by prohibiting anticompetitive agreements, harmful conduct by monopolists, and anticompetitive mergers. Consumer protection, on the other hand, approaches markets from the demand-side, addressing, *inter alia*, information asymmetries between sellers and buyers, false or misleading advertising, and abuses that may derive from contracts with unclear or disproportionate terms. Consumer protection is coextensive with the FTC's "unfair and deceptive acts and practices"

⁶⁵ See Seth B. Sacher & John M. Yun, *Twelve Fallacies of the 'Neo-Antitrust' Movement*, GEO. MASON L. REV. (forthcoming 2020), <https://ssrn.com/abstract=3369013>.

⁶⁶ See OECD, *supra* note 48; see also Joshua D. Wright, *The Antitrust/Consumer Protection Paradox: Two Policies at War with Each Other*, 121 YALE L.J. 2216 (2012); Mark Armstrong, *Interactions Between Competition and Consumer Policy*, COMPETITION POLICY INT'L, at 97, 100-12 (Spring 2008).

⁶⁷ See Julie Brill, *Competition and Consumer Protection: Strange Bedfellows or Best Friends?*, THE ANTITRUST SOURCE (Dec. 2010).

jurisdiction, which can be thought of as policing the market against conduct that distorts the manner in which consumers make decisions.⁶⁸

Coordination of these policies can lead to greater consumer welfare and, applied consistently, each policy strengthens the other.⁶⁹ For example, in competitive markets, producers have incentives to provide better goods and services in order to attract customers away from their rivals. At the same time, when consumers are able to exercise their choices effectively, they can better discipline producers.

Antitrust and consumer protection policies are different, however, in their scope and in the types of conduct addressed.⁷⁰ Conduct prohibited by consumer protection law usually involves individual businesses acting in a way that has a direct effect on consumers, for example, by misleading them through false or deceptive advertising.⁷¹ On the other hand, antitrust involves conduct, such as price-fixing and mergers, that affects an entire market.

Moreover, antitrust may raises challenges for consumer protection and *vice versa*.⁷² For instance, consumer protection rules, such as prohibitions on comparative

⁶⁸ See Timothy J. Muris, Former Chairman, U.S. Fed. Trade Comm'n, Remarks at Fordham Corporate Law Institute's Twenty-Ninth Annual Conference on International Antitrust Law and Policy: The Interface of Competition and Consumer Protection (Oct 31, 2002), https://www.ftc.gov/sites/default/files/documents/public_statements/interface-competition-and-consumer-protection/021031fordham.pdf.

⁶⁹ See OECD, *supra* note 48.

⁷⁰ See Brill, *supra* note 67 at 1.

⁷¹ See J. HOWARD BEALES & TIMOTHY J. MURIS, STATE AND FEDERAL REGULATION OF NATIONAL ADVERTISING, at Ch. 2 (AEI Press, 1993).

⁷² See Wright, *supra* note 66.

advertising, mandatory product standards, and price transparency requirements may affect competition by facilitating collusion or limiting competition between firms.

In brief, antitrust and consumer protection policies should not be comingled in such a way as to confuse either or both disciplines. Importing consumer protection goals into antitrust analysis risks weakening enforcement by introducing public policy considerations and tradeoffs unrelated to competition. That said, to the extent that employee harm is based upon information asymmetry, there is a potential role for consumer protection where the “consumer” in question is the employee faced with a noncompete agreement. While the literature in this area is fairly sparse, it stands to reason that employees are better able to assess tradeoffs if they are clearly presented with the terms of a noncompete clause before making an employment decision.

Conclusions and Policy Recommendations

We strongly believe that proposals urging the FTC to prohibit or restrict the use of noncompetes (even for a subset of the labor force) are deficient for several reasons. First, despite the recent increase in empirical studies, the evidence does not suggest a reliable and predictable link between the use of noncompetes and the effect on employee welfare. Second, changes in employee welfare do not map in a reliable way to changes in consumer welfare. The goals of antitrust policy, and of Section 5 of the FTC Act, are firmly grounded in the consumer welfare standard; deviating from that

standard would contradict the FTC's UMC policy, lead to inefficient enforcement, and increase legal uncertainty. Third, state laws already and extensively control the use of noncompetes; therefore, creating a new FTC rule would likely add complexity and uncertainty about how the rule would interface with existing state laws.